

Message Text

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PRS-01 SS-15 INT-05 AGRE-00 FEAE-00 /122 W
-----191751Z 099665 /42

O R 191716Z JAN 77
FM AMEMBASSY LONDON
TO SECSTATE WASHDC IMMEDIATE 9647
TREASURY DEPT WASHDC IMMEDIATE
INFO AMEMBASSY BONN
AMEMBASSY BRUSSELS
AMEMBASSY DUBLIN
AMEMBASSY NEW DELHI
AMEMBASSY PARIS
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DEPARTMENT PASS FEDERAL RESERVE BOARD

TREASURY FOR DONALD E. SYVRUD, OASIA

E.O. 11652: N/A
TAGS: ECON, UK
SUBJECT: ECONOMIC DEVELOPMENTS FOR PERIOD JAN. 13-19

SUMMARY: THE GOVERNOR OF THE BANK OF ENGLAND EXPLAINS
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WHY MONETARY TARGETS WILL BE REGARDED AS FLEXIBLE. THE
BANK OF ENGLAND TOOK STEPS TO RELEASE 760 MILLION POUNDS
IN SPECIAL DEPOSITS AS A TECHNICAL MEASURE. THE CURRENT
BANKING STATISTICS SHOWED MONEY STOCK GROWTH WITHIN TAR-
GET RANGE. INDUSTRIAL PRODUCTION REMAINED IN NOVEMBER
AT ITS OCTOBER LEVELS. SEASONALLY ADJUSTED RETAIL SALE
FIGURES FOR DECEMBER SHOWED A DECLINE IN VOLUME FROM NO-

MEMBER'S HIGH LEVELS. THE CENTRAL GOVERNMENT BORROWING REQUIREMENT CONTINUED TO RUN BEHIND LAST APRIL'S BUDGET. DISAGGREGATED DATA FOR THIRD QUARTER'S GDP SHOWED THAT THERE HAS BEEN A MODEST RECOVERY IN REAL INVESTMENT. RECORD BIDS WERE MADE AT LAST FRIDAY'S TREASURY BILL AUCTION AND APPLICATIONS FOR A RECORD GILT ISSUE WILL BE TAKEN THIS THURSDAY. END SUMMARY.

1. GORDON RICHARDSON, GOVERNOR OF THE BANK OF ENGLAND, TOOK THE OCCASION OF A SPEECH TO THE INSTITUTE OF BANKERS IN SCOTLAND, TO EXPLAIN THE NEED FOR TARGETS OF MONETARY EXPANSION, AND THE NEED TO MAINTAIN FLEXIBILITY IN USING THESE TARGETS. IN PARTICULAR HE NOTED THAT VALUE OF ANNOUNCED TARGETS "IS TO SERVE NOTICE THAT EXCESSIVE INCREASES IN DOMESTIC COSTS WILL COME UP AGAINST RESISTANCE, AND TO TEMPER AMONG OTHER THINGS INFLATIONARY EXPECTATIONS. THE ANNOUNCED TARGETS ARE NOW STATED IN TERMS OF A STERLING DOMESTIC CREDIT EXPANSION (DCE) RATHER THAN IN TERMS OF THE GROWTH OF M3, THE BROADLY DEFINED MONEY STOCK AS HAD PREVIOUSLY BEEN THE CASE. THE TARGETS WERE CHANGED ON TWO GROUNDS. FIRST, GOVERNOR RICHARDSON ASSERTED, DOMESTIC CREDIT EXPANSION IS USUALLY ACCOMPANIED BY A BALANCE OF PAYMENTS DEFICIT. SO THAT NEGLECTING THE BALANCE OF PAYMENTS IN THE DCE MEASURE SHOULD NOT MATTER A GREAT DEAL. HE POINTED OUT THAT WHEN NORTH SEA OIL RESTORES THE BALANCE OF PAYMENTS TO A SURPLUS, A RETURN TO TARGETS COUCHAD IN TERMS OF M3 COULD BE ACCEPTED. SECOND, HE ASSERTED THAT THE DOMESTIC IMPACT OF CREDIT EXPANSION IS THE VARIABLE MOST DIRECTLY UNDER THE AUTHORITY.

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TIES CONTROL.

HE MAINTAINED THAT TARGETS FOR MONETARY EXPANSION MUST BE FLEXIBLE FOR A VARIETY OF REASONS. AS A TECHNICAL MATTER HE OBSERVED THAT "IN THE UNITED KINGDOM WE HAVE NOT RECENTLY BEEN ABLE TO OBSERVE A CONTINUING STABLE RELATIONSHIP BETWEEN MONEY AND INCOMES." FURTHERMORE, ANY MONETARY TARGETS MUST BE AMENDED AS STRUCTURAL CHANGES IN THE FINANCIAL SECTOR OCCUR. BEYOND THESE, HOWEVER, LAY A FUNDAMENTAL NEED TO ADAPT MONETARY TARGETS TO DEVELOPMENTS OF VARIABLES WHICH EXPRESSED "THE TRUE OBJECTIVES OF POLICY," THE RATES OF INFLATION, UNEMPLOYMENT, AND GROWTH AND THE BALANCE OF PAYMENTS.

2. THE BANK OF ENGLAND, ON JANUARY 13, ANNOUNCED THAT IT WAS REDUCING THE RATE OF CALL FOR SPECIAL DEPOSITS' FROM 5 PERCENT TO 3 PERCENT. THIS WILL FREE 760 MILLION POUNDS IN SPECIAL DEPOSITS, AND AVOID THE PAYMENT OF AN ADDITIONAL 360 MILLION POUNDS PREVIOUSLY DUE ON JANUARY 28 UNDER A 6 PERCENT RATE OF CALL. (SEE

LONDON 600).

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3. ESTIMATES OF DECEMBER'S SEASONALLY ADJUSTED VISIBLE
TRADE AND CURRENT ACCOUNT BALANCE WERE RELEASED ON JANU-
ARY 17, SHOWING A VISIBLE TRADE DEFICIT OF 179 MILLION
POUNDS AND A CURRENT ACCOUNT SURPLUS OF 21 MILLION POUNDS.
THE VISIBLE TRADE DEFICIT FOR 1976 IS PROVISIONALLY ESTI-
MATED TO BE 3611 MILLION POUNDS AND THE CURRENT ACCOUNT
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DEFICIT TO BE 1526 MILLION POUNDS (SEE LONDON 811).

4. BANKING STATISTICS SHOWED THE BROADLY DEFINED MONEY STOCK M3, SEASONALLY ADJUSTED, FALLING 133 MILLION POUNDS IN THE NOVEMBER 17 - DECEMBER 8 BANKING MONTH. THE NARROWLY DEFINED MONEY STOCK M1 ROSE 160 MILLION POUNDS. M3 IS HERE TAKEN TO BE THE NEW MEASURE WHICH EXCLUDES FOREIGN CURRENCY HOLDINGS OF U.K. RESIDENTS. THE OLD MEASURE WOULD HAVE DECLINED 265 MILLION POUNDS. THE DECLINE IN M3 BRINGS THE GROWTH RATE OF THE MONEY STOCK WITHIN THE TARGET RANGE OF 9-13 PERCENT (SEE LONDON 814).

5. INDUSTRIAL PRODUCTION. INDUSTRIAL PRODUCTION REMAINED VIRTUALLY UNCHANGED IN NOVEMBER WITH THE 1970 BASED INDEX RISING TO 102.6 FROM 102.5 IN OCTOBER. THE SLIGHTLY NARROWER INDEX OF MANUFACTURING PRODUCTION DECLINED BY 0.5 PERCENT TO 103.8 FROM A REVISED 104.3 IN OCTOBER. THE LATEST SET OF FIGURES CONTAIN A SERIES OF MINOR UPWARD REVISIONS. THESE ARE SUMMARIZED BY QUARTER IN THE FOLLOWING TABLE:

	OVERALL INDEX		MANUFACTURING INDEX	
	OLD	NEW	OLD	NEW
1976-I	101.9	102.0	101.8	102.0
1976-II	102.1	102.4	103.2	103.4
1976-III	101.6	101.3	102.6	103.2
OCTOBER	102.5		103.3	104.3

THE NOVEMBER FIGURES SHOW SIGNIFICANT RISES IN "CHEMICALS, COAL AND PETROLEUM PRODUCTS" (4 PERCENT), MINING AND QUARRYING (3.2 PERCENT) AND "GAS, ELECTRICITY AND WATER" (5 PERCENT). OTHER SECTORS WERE LARGELY UNCHANGED WITH EXCEPTION OF METAL MANUFACTURE WHERE A DECLINE OF 8.9 PERCENT WAS RECORDED. ON A MARKET SECTOR BASIS, THE OUTPUT OF CONSUMER GOODS AND INTERMEDIATE GOODS INDUSTRIES WAS UNCHANGED IN NOVEMBER, WHILE INVESTMENT GOODS OUTPUT SHOWED A MARGINAL DECLINE (0.1 PERCENT)

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WITH THE NOVEMBER FIGURES IN HAND, 6 MONTHS HAVE PASSED SINCE INDUSTRIAL PRODUCTION REACHED ITS 1976 PEAK. THE INDEX HAS RECOVERED LESS THAN 60 PERCENT OF THE LOSS INCURRED DURING THE SUMMER MONTHS. IT IS UNLIKELY THAT THE DECEMBER FIGURES WILL ADD SUBSTANTIALLY TO THAT FIGURE BECAUSE OF THE EXTENSIVE PLANT SHUTDOWNS ASSOCIATED WITH THE LONG CHRISTMAS-NEW YEAR BREAK. AS A RESULT INDUSTRIAL OUTPUT IN 1977 WILL START FROM A 1976

BASE LITTLE CHANGED FROM A YEAR EARLIER.

6. RETAIL SALES. THE VOLUME OF RETAIL SALES, SEASONALLY ADJUSTED, DECLINED IN DECEMBER. ON A PROVISIONAL BASIS, THE INDEX OF RETAIL SALES VOLUME (1971 EQUALS 100) DECLINED BY 0.7 PERCENT TO 108.5 FROM 109.3 IN NOVEMBER. IT SHOULD BE NOTED THAT THE NOVEMBER FIGURE WAS THE HIGHEST SINCE JANUARY AND IS BELIEVED TO REFLECT PURCHASES IN ANTICIPATION OF AN INCREASE IN VALUE ADDED TAXATION WHICH IN THE EVENT, NEVER MATERIALIZED. ALTHOUGH THE AVERAGE VOLUME OF RETAIL SALES FOR 1976 WAS VIRTUALLY UNCHANGED FROM THAT OF 1975, THE DECEMBER INDEX WAS 1.4 PERCENT ABOVE THE LEVEL OF DECEMBER 1975. OVER THE 6 MONTHS SINCE JULY, ALL OF THE MOVEMENT IN THE INDEX HAS BEEN IN A LATERAL DIRECTION.

7. CENTRAL GOVERNMENT BORROWING REQUIREMENT. THE CENTRAL GOVERNMENT BORROWING REQUIREMENT (CGBR) DECLINED SHARPLY IN DECEMBER. CURRENT REVENUES ROSE BY 19 PERCENT COMPARED WITH A YEAR EARLIER WHICH CURRENT EXPENDITURE DECLINED BY 9 PERCENT OVER THE SAME PERIOD. PART OF THIS DECLINE WAS CAUSED BY THE ADVANCING OF 250 MILLION POUNDS OF PAYMENTS TO LOCAL AUTHORITIES FROM DECEMBER TO NOVEMBER. AS A RESULT THE CGBR AMOUNTED TO 0.793 BILLION POUNDS IN DECEMBER COMPARED WITH 1.635 BILLION IN DECEMBER 1975. OVER THE FIRST NINE MONTHS OF THE FISCAL YEAR (FY 76), CURRENT REVENUES AND EXPENDITURES HAVE BEEN RUNNING AT OR NEAR LEVELS FORECAST IN LAST APRIL'S BUDGET.

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HOWEVER, THERE HAS BEEN A LARGE DECLINE IN CAPITAL EXPENDITURES FINANCED BY LOANS FROM THE CENTRAL GOVERNMENT. IN EFFECT, LOCAL AUTHORITIES AND NATIONALIZED INDUSTRIES HAVE BEEN BORROWING FROM OTHER SOURCES. THERE HAS BEEN A DECLINE OF 22.4 PERCENT IN SUCH BORROWING DURING THE

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FM AMEMBASSY LONDON

TO SECSTATE WASHDC IMMEDIATE 9649

TREASURY DEPT WASHDC IMMEDIATE

INFO AMEMBASSY BONN

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FIRST NINE MONTHS OF FY 76 WITH THE CGBR 28.1 PERCENT
 LOWER THAN IT WAS DURING THE SAME PERIOD IN FY 75. THE
 FOLLOWING TABLE SUMMARIZES THE DECEMBER DATA AS WELL AS
 THAT COVERING THE FIRST NINE MONTHS OF THE FISCAL YEAR:

POUNDS MILLIONS

1976-77 1 APRIL -

BUDGET 1 DECEMBER DECEMBER

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FORECAST 1975 1976 1975 1976

CONSOLIDATED FUND

REVENUE 33,197 20,377 23,451 2,111 2,513

EXPENDITURE 39,915 26,126 28,677 3,647 3,334

DEFICIT MET FROM

THE NATIONAL

LOANS FUND -6,718 -5,749 -5,226 -1,536 - 821

OTHER NATIONAL

LOANS FUND

TRANSACTIONS

RECEIPTS 4,900 2,442 3,148 271 276

PAYMENTS 8,932 4,358 3,873 316 226

TOTAL NET BORROW-
ING BY THE
NATIONAL
LOANS FUND -10,750 -7,665 -5,951 -1,581 -771
OTHER FUNDS AND
ACCOUNTS 324 263 627 -54 -22
CENTRAL GOVERN-
MENT BORROW-
ING REQUIRE-
MENT -10,426 -7,402 -5,324 -1,635 -793

8. THE BANK OF ENGLAND ANNOUNCED FRIDAY THE LARGEST GILT
ISSUE IT HAS MADE TO DATE. THIS WILL BE 1.25 BILLION
POUNDS OF A 13-3/4 PERCENT 1993, WITH AN ISSUE PRICE OF
96 AND A YIELD TO REDEMPTION OF 14.38 PERCENT. THIS
BRINGS THE TOTAL NOMINAL VALUE OF GILT ISSUES SINCE THE
FIRST OF SEPTEMBER TO 7.3 BILLION POUNDS.

9. GDP. DISAGGREGATED DATA FOR THIRD QUARTER GDP INDI-
CATE THAT, ON AN EXPENDITURE BASIS, GROSS FIXED INVEST-
MENT ROSE BY 4.0 PERCENT IN REAL TERMS WHILE CONSUMPTION
WAS INCREASING BY 1.3 PERCENT. THESE RISES WERE OFFSET
BY DECLINES OF 0.3 PERCENT IN THE VOLUME OF GOVERNMENT
PURCHASES, 0.5 PERCENT IN EXPORTS AND A RISE IN IMPORT
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VOLUME OF 0.6 PERCENT. BOTH FINAL EXPENDITURE AND TOTAL
GDP ROSE BY 1.5 PERCENT DURING THE THIRD QUARTER. HOW-
EVER. BETWEEN THE THIRD QUARTERS OF 1975 AND 1976, FINAL
EXPENDITURE ROSE BY 3.5 PERCENT IN REAL TERMS WHILE GDP
GROWTH WAS 2.7 PERCENT, THE DIFFERENCE DUE TO A DECLINE
IN INVENTORIES OF 200 MILLION POUNDS (1970 PRICES) DURING
THE PERIOD.

THE RISE IN INVESTMENT, WHILE ENCOURAGING, MEANS THAT
FIXED CAPITAL FORMATION HAS RETURNED TO THE LEVEL OF THE
FOURTH QUARTER OF 1975. IN FACT, GROSS FIXED CAPITAL
FORMATION OVER THE FIRST 3 QUARTERS OF 1976 WAS 3.1 PER-
CENT BELOW THE SAME PERIOD IN 1975.

TURNING TO FACTOR INCOMES (EXPRESSED AT CURRENT
PRICES), INCOME FROM EMPLOYMENT ROSE 2.5 PERCENT IN THE
THIRD QUARTER. WITHIN THAT FIGURE WAGES AND SALARIES
ROSE BY 2.4 PERCENT. COMPARED WITH THE THIRD QUARTER OF
1975, WAGES AND SALARIES HAVE RISEN BY 11.6 PERCENT.
GROSS COMPANY PROFITS AFTER ADJUSTMENT FOR INVENTORY AP-
PRECIATION DECLINED BY 3.5 PERCENT IN THE THIRD QUARTER
BUT REMAIN 13.9 PERCENT HIGHER THAN IN THE THIRD QUARTER
OF 1975. TOTAL PRE-TAX INCOMES ROSE BY 2.1 PERCENT IN
THE THIRD QUARTER WHILE DISPOSABLE INCOME WAS UP BY 4.1
PERCENT AS A RESULT OF A TAX REBATE IN AUGUST. HELPED
BY THE REBATE, REAL DISPOSABLE INCOME ROSE BY 0.7 PERCENT

IN THIRD QUARTER. NEVERTHELESS THERE WAS A DECLINE OF
1 6 PERCENT IN REAL INCOMES WHEN THE FIRST 9 MONTHS OF
1976 ARE COMPARED WITH THE SAME PERIOD IN 1975.

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10 EXCHANGE RATE AND GOLD

	EFFECTIVE		
	EXCHANGE	DEPRECIATION	GOLD
DATE	RATE (\$)	(PERCENT)	(\$)
1/12	1.7070	43.5	130-5/8
1/13	1.7115	43.2	132-1/8

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1/14	1.7110	43.1	131-5/8
1/17	1.7138	43.0	132-3/8
1/18	1.7160	42.9	133-1/8

CHANGE 1/11-1/18 UP 0.0075 NARROWED 0.6 UP 1

11.FORWARD DISCOUNT ON STERLING

DATE	1 MONTH	3 MONTHS	6 MONTHS
1/12	1.65	4.10	7.10
1/13	1.60	4.05	7.15
1/14	1.53	4.03	7.03
1/17	1.60	3.88	6.78
1/18	1.52	3.75	6.60

CHANGE 1/11-1/18 NARROWED 0.03 NARROWED 0.18 NARROWED 0.33

(ALL FIGURES IN CENTS)

12.EURODOLLAR INTEREST RATES

DATE	1 MONTH	3 MONTHS	6 MONTHS
1/12	4-3/4	5-1/8	5-5/8
1/13	5	5-1/4	5-5/8
1/14	5-1/4	5-1/4	5-5/8
1/17	4-7/8	5-1/4	5-5/8
1/18	5	5-3/8	5-3/4

CHANGE 1/11-1/18 UNCHANGED DOWN 1/8 UP 1/4

13. THREE-MONTH LONDON INTERBANK - EURODOLLAR INTEREST
RATE DIFFERENTIAL

DATE	
1/12	9-7/16
1/13	9-5/16
1/14	9-3/16
1/17	9-7/16
1/18	9-1/8

CHANGE 1/11-1/18 NARROWED 1/8

14. STERLING CERTIFICATES OF DEPOSIT

DATE	1 MONTH	3 MONTHS	6 MONTHS
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1/12	15-1/8	14-1/4	13-31/64
1/13	14-31/32	14-5/32	13-1/4
1/14	15-1/32	14-3/32	13-11/32
1/17	14-29/32	14-9/64	13-13/32
1/18	14-21/32	L4	13-7/32

CHANGE 1/11-1/18 DOWN 7/32 DOWN 5/64 UP 1/32

15. THE MINIMUM LENDING RATE WAS UNCHANGED AT 14 PERCENT AFTER FRIDAY'S TREASURY BILL AUCTION. THE TREASURY BILL RATE FELL 0.0129 PERCENT TO 13.25 7 PERCENT, AS RECORD BIDS AMOUNTING TO 2311.39 MILLION POUNDS WERE RECEIVED FOR THE 300 MILLION POUNDS IN TREASURY BILLS TENDERED. THIS WEEK 300 MILLION POUNDS WILL BE ON OFFER AS 500 MILLION POUNDS MATURE.

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